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SLBA
Student Loan Borrower Assistance

Response to U.S. Department of Education Office of Federal Student Aid

Request for Information: Title IV Student Loan Servicing

January 30, 2015

We thank the Department for seeking information to improve servicing for federal student loan borrowers. This response is submitted by the National Consumer Law Center's Student Loan Borrower Assistance Project on behalf of its low-income clients. The National Consumer Law Center (NCLC) is a nonprofit organization specializing in consumer issues on behalf of low-income people. NCLC works with thousands of legal services, government and private attorneys and their clients, as well as community groups and organizations that represent low-income and older individuals on consumer issues. NCLC's Student Loan Borrower Assistance Project provides information about student rights and responsibilities for borrowers and advocates and provides direct legal representation to student loan borrowers.[1]

As a start, the Department should affirm that the needs of student borrowers come first. This is not self-evident because unlike the Consumer Financial Protection Bureau, the Office of Federal Student Aid (FSA) by its very nature has multiple constituencies, often with conflicting needs and goals. Students are only one of these groups and are often the least powerful.

We urge the Department to define quality servicing as a service that leads to optimal outcomes for borrowers and ensures that they have reliable access to relief programs. This definition prioritizes the needs of student borrowers, focusing on default prevention and ensuring that financially distressed borrowers can get the relief they are entitled to and in many cases get a

[1] Most of the clients we represent are low-income borrowers living in Massachusetts. We work with other advocates across the country representing low-income clients. We also seek to increase public understanding of student lending issues and to identity policy solutions to promote access to education, lessen student debt burdens and make loan repayment more manageable. See the Project's web site at www.studentloanborrowerassistance.org. NCLC also publishes and annually supplements practice treatises which describe the law currently applicable to all types of consumer transactions, including *Student Loan Law*. This response was written by Deanne Loonin.

fresh start. Preventing defaults ultimately helps borrowers AND taxpayers by limiting the costs of servicing and collection interventions and by helping borrowers get back into repayment or find other relief.

I. Key Federal Student Loan Servicing Concerns

The Department's current servicing system relies on proprietary contract commissions intended to incentivize contractors to provide quality service. This is an opaque process that fails to ensure borrower access to entitlement programs and fails to provide public access to critical information about servicer performance. In addition, the lack of a complaint, error resolution and appeals process makes it extremely difficult for borrowers to get relief when servicers make mistakes or fail to do their jobs properly. The situation is exacerbated by the government's failure to sanction servicers that violate the law.

Relying on a proprietary system hidden from the public and from borrowers is not appropriate in the federal student loan context. Federal student lending is not a typical marketplace. Federal student loans are government products *and* borrowers are *entitled* to various relief options by law. All borrowers should have the same access to these programs. It makes no sense that due to the vagaries of competition, only some borrowers have access to relief and comprehensive counseling.

The main problem is that federal student loan borrowers do not receive consistent quality service. Among other issues, we see servicers pushing borrowers into the quickest options, such as forbearance, rather than explaining and assisting borrowers to obtain more favorable long-term solutions, such as income-driven repayment. We have provided many examples of servicing errors and legal violations to the Department and other agencies and are available to discuss further.

Our recommendations preserve some elements of the current system. However, unlike the current system, private contracts are only one component of our recommended federal student loan servicing structure.

II. Recommendations for Reform

The system we recommend retains a contract system with multiple servicers that:

- Eliminates private branding
- Creates a single portal for borrower access, and
- Allows dissatisfied borrowers to switch servicers.

In addition to the contract system, we recommend a system that:

- Sets out clear and public borrower rights to reliable and efficient customer service, account and other information

- Establishes an informal and formal appeals process and mandatory loss mitigation measures
- Includes a complaint system to track and measure contractor performance
- Involves rigorous enforcement to punish bad actors
- Provides public data tracking of servicer performance
- Requires government study of what works to prevent defaults and reach particular at-risk populations, and
- Creates a separate, neutral, government-certified corps of non-profit counselors to assist borrowers.

A. Limit the Number of Servicers and Create a Single Point of Entry

We recommend working with multiple servicers and opening up competition beyond the same old players. The advantage of working with multiple servicers is to spur a "race to the top." Hiring just one contractor runs the risk of a monopoly effect in which the single contractor is not sufficiently incentivized to provide quality service. Further, the government can terminate or sanction servicers more readily when it has the option of transferring accounts to competitors.

The number of contracts should be limited to keep the system manageable and to avoid borrower confusion. In addition, the Department must eliminate co-branding and create a single point of entry for borrowers to communicate with servicers. Current servicers co-brand all correspondence, leading to confusion among borrowers as to why they are hearing from an unknown agency. This confusion has serious consequences, leading to communication breakdowns and sometimes to defaults.

Under the proposed single portal system, all borrowers will receive communications that are clearly from the government, not from a private servicer or contractor that the borrower may or may not know and may not even associate with student loans.

We believe that this system has many advantages and will eliminate the problems associated with co-branding and borrower confusion. The main disadvantage may be that more aggressive companies may not want to work in an environment where their brand is "behind the scenes." We believe that this is actually an advantage in that it weeds out companies that are more interested in their own profits rather than properly administering a government program.

B. Allow Dissatisfied Borrowers to Switch Servicers

The current system not only fails to provide a clear complaint and dispute resolution system, but it then traps borrowers with inferior servicers. Among other problems, Direct Loan borrowers are not allowed to switch servicers. The only exception is the recent addition of a servicer selection system for borrowers consolidating their loans. This system is flawed in many ways and is open to potential abuse by third party debt relief providers and others. [2] In addition, borrowers do not have sufficient information to make informed selections.

The Department should consider retaining the current system of randomly assigning borrowers, whether consolidating or not, to their initial servicers and then allow dissatisfied borrowers to switch. The main advantage of this proposal is that companies will know that they may lose customers if they do not perform. There is a potential disadvantage in that this may lead to overly aggressive marketing by servicers seeking to lure new customers. The Department should address this by both cracking down on aggressive sales tactics and by allowing borrowers to switch, but <u>randomly</u> assigning them a new servicer.

C. Strengthen Contract Incentives

The current performance metrics that are used to allocate accounts are based mainly on borrower surveys and the number of borrowers and amounts of loans in delinquency and default. The Department made some important changes to the incentive system in September 2014, but much more needs to be done to strengthen these incentives, including:

1. Tie compensation to actual results and actual performance

Servicers should be incentivized first to counsel borrowers on the full range of relief options and help them identify optimal programs. Second, the incentives should be tied to how well borrowers obtain optimal outcomes. For example, even if there is not a specific target for numbers of borrowers in income driven repayment (IDR), servicers can be evaluated and paid based on how efficiently they process IDR applications, attrition rates for borrowers on IDR plans, and percentage of eligible borrowers on IDR. Among other actions, this requires collecting and providing public data about how servicers are performing. Compensation should also be tied to numbers of complaints and complaint resolutions.

2. Phase Out "Smile Surveys"

The current survey system is flawed in that it appears to rely mostly on borrower satisfaction (also known as smile surveys). Borrowers may report satisfaction, but this is not necessarily the same as favorable outcomes. This is because borrowers will not necessarily know if they could have obtained more favorable results because they do not know the full range of available options.

Over time, as there is additional data on actual performance, we recommend eliminating the survey metric. Among other advantages, this should save money and lead to performance metrics more closely tied to actual performance.

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[2] We summarized these concerns in a letter to FSA and the CFPB dated March 6, 2014.

3. Specialty Servicers

The Department has asked about creating incentives depending on how well servicers assist at-risk borrowers and/or creating specialty servicers to work with certain populations. We believe that this idea is worthy of further study. The Department must first do more research to understand which borrowers are most at risk and what sorts of interventions are most effective in preventing defaults for different populations. There is a shocking dearth of research on why borrowers default and the role of servicing in default. [3] Although there has been some private study, the government is in the best position to research these issues as it has the most access to data and resources.

We have serious concerns, however, about a system that, for example, sends all "at risk" borrowers to a single specialty servicer. This could segregate the neediest borrowers, possibly with the least effective servicer. As discussed throughout these comments, *all* borrowers should have consistent access to high quality servicing and to entitlement programs. As an alternative, we believe that each servicer could set up an internal unit charged with identifying and working with at-risk populations.

There may be particular interventions or means of communications that are more effective in reaching some populations and all servicers should be required to develop such measures. An incentive system could be considered that would pay servicers higher amounts if they successfully enroll certain at risk borrowers in relief programs rather than paying more simply because the servicer says it is trying to work with these borrowers.

We believe that the specialty servicer model should be studied, but at least based on current experience, it is more effective to use a separate specialty servicer to administer a particular program such as disability discharge rather than to work exclusively with a specific population such as borrowers who have dropped out from school. For example, although there is still ample room for improvement, the relatively new system in which Nelnet is the specialty servicer for disability discharges is a big improvement over the prior system that involved all servicers administering some aspects of the discharge process.

D. Moving Beyond Private Contracts to Ensure Quality Service

Even assuming that servicers always act rationally and follow financial incentives, they still make mistakes. When this happens, regardless of financial incentives, the borrowers have no formal way to force the servicers to get it right. Borrowers are not parties to the contracts between the government and the servicers, so they cannot directly enforce the contracts. In any case, so much of the contracting process happens behind the scenes that borrowers rarely even know what their rights are.

[3] See generally The National Consumer Law Center, "The Student Loan Default Trap: Why Borrowers Default and What Can Be Done" (July 2012).

Therefore we recommend that the current system include strong and clear borrowers' rights, with an appeal system and a complaint process. It should include the following key elements:

1. Establish Clear Borrower Standards and Protections

Currently there are explicit due diligence regulations for FFEL and Perkins loans only. There are no such regulations for Direct Loans. Regardless, these due diligence standards are only about required communication with borrowers, not specific borrower rights.

The Direct Loan contracts that are publicly available include some "protections" for borrowers such as provisions that limit soliciting or promoting of other products while servicing Department of Education debt and that require timely and accurate processing of discharge requests and timely and accurate responses to written and email questions. In general, the Department merely sets high-level goals in the servicer contracts, such as requiring "best of business" practices or meeting "all statutory and regulatory requirements." The Department then allows a significant level of variation within these high level goals.

The absence of clear borrower protections contrasts with other consumer credit areas such as credit cards and mortgages. In its October 2013 report, the CFPB pointed to protections in the Real Estate Settlement Procedures Act (RESPA) for mortgages and the CARD Act for credit cards and the need to examine whether these types of reforms could apply to the student loan servicing market. The CFPB pointed out that some of the provisions in mortgage servicing rules that could apply to student loan servicers include notice of transfer of loan servicing, timely transfer of documents to new services, payoff statements, error resolution and dispute review procedures, continuity of contact, records retention and early intervention for borrowers nearing default.[4]

Therefore, a key advantage in creating clear borrower servicing standards is that student loan borrowers will be at least as protected as other consumers. The current lack of borrower protections for student loan servicing is inexplicable and inexcusable.

We strongly recommend that the servicing system include clear borrower rights to quality customer service, including rights to account information and information about transfers of accounts. In addition, we urge the Department to consider the ideas presented below for loss mitigation and dispute resolution.

We cannot think of disadvantages to this system other than that the current opaque system makes it easier for contractors to evade the law. There could be a problem if the regulations are overly prescriptive and burdensome, but there is a lot of middle ground in between no standards and overly burdensome standards. There may be some costs associated

[4] Consumer Financial Protection Bureau, "Annual Report of the CFPB Student Loan Ombudsman" (October 16, 2013).

with proper oversight, but these are necessary costs and ultimately creating a more efficient system should save money.

2. Require Pre-Default Loss Mitigation and an Appeals Process

All borrowers in delinquency should receive a simple notice that allows them to request that the servicer review the borrower's account and inform the borrower of all programs they could apply for. The "request for evaluation notice" could require some basic information such as income, but overall should be as simple as the check box on the current repayment plan selection form that allows borrowers to request that the servicer determine which repayment plan will provide the lowest monthly payment option.

Upon receipt of this request for evaluation, the "delinquency clock" should stop so that there are no further negative consequences to the borrower while the servicer evaluates the account. The servicer should be required to respond within a reasonable period of time with a notice clearly stating which programs the borrower is eligible for. The most common options such as discharges and affordable repayment should be highlighted at the top of the list.

The advantage of this system is that it provides clear paths to relief programs for borrowers. Further, the government can use the results to track outcomes and to measure servicer performance.

There should be an escalation system so that the borrower can seek review if she disagrees with the servicer's response. There should also be a more formal appeals process for borrowers who apply for particular programs and believe they are wrongly denied. For illustrative purposes, we urge the Department to study the Rural Housing (RHS) system. The Rural Housing Service (RHS) is a division of the Department of Agriculture. Formerly known as the Farmers Home Administration (FmHA), RHS manages an insured single-family home loan program and a direct loan program. The rules for RHS's insured loan program are similar to those for FHA-insured loans. The RHS direct loan program is most analogous to the direct student loan program and RHS's direct loan servicing guidelines offer a number of useful comparison points. The governing statutes and regulations provide for a number of options to make ongoing payments affordable and help borrowers avoid default. RHS also offers special loss mitigation alternatives to borrowers facing default.[5]

The most important aspects of the existing mortgage loss modification and mitigation programs, including RHS that the Department should include in its program are:

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[5] Under its direct loan program, RHS offers loans for the purchase and improvement of homes. 42 U.S.C. § 1472, *et seq.;* 7 C.F.R. Part 3550. The direct loans are available to borrowers who could not otherwise obtain private credit. Nationally, over one million homes are financed through the RHS direct loan program. All RHS direct loans are serviced by a single national servicer, the RHS Centralized Servicing Center (CSC), located in St. Louis. RHS's Centralized Servicing Center publishes a guide containing all pertinent servicing guidelines. Handbook HB-2-3550 DLOS Centralized Servicing Center, available at http://www.rurdev.usda.gov/handbooks.html. These Handbook guidelines incorporate statutory and regulatory provisions as cited throughout the document. 42 U.S.C. § 1472, *et seq*. and 7 C.F.R. part 3550.

1. Mandatory written notices of decisions on requests for assistance
2. Duty to review for all options
3. Appeal rights
4. Interactions between reviews for assistance and enforcement of the debt obligation so that the delinquency clock is stopped during evaluation of options
5. Enforcement by borrowers, and
6. Keeping the program simple so that borrowers do not need legal counsel to get relief.

In addition, we urge the Department to create a system that requires mandatory loss mitigation reviews prior to the declaration of a default regardless of whether a borrower requests intervention. There is some precedent for these types of reviews in the mortgage area, such as under FHA and HAMP guidelines. For example, with the HAMP program, servicers must solicit borrowers in imminent risk of default for loss mitigation options. The servicer cannot refer the loan to foreclosure unless the review has been completed or it can document attempts to conduct the review.

The Department should study the various mortgage modification and loss mitigation programs to learn about good practices and potential pitfalls. In the latter category, we urge the Department to avoid common problems in the mortgage programs, including:

1. **The "complete application" requirement.** For example, the CFPB and government sponsored enterprise (GSE) rules severely limit borrower rights and remedies by tying these to the arbitrary concept of a "complete application" for loss mitigation. Servicers frequently abuse this requirement by demanding unnecessary and duplicative documents.

2. **Limiting rights to certain options only**. The CFPB and GSE rules, as well as the national mortgage settlement (NMS) standards, limit borrower rights involving notices and appeals to servicer decisions that denied a loan modification. As a result, rights to notice and appeal do not apply to many important servicer actions that do not involve a loan modification.

3. **"One bite at the apple" rules.** The CFPB and GSE rules attach most borrower rights and remedies to only one complete loss mitigation application to a servicer. Borrowers who experience a change in circumstances after an earlier application are not entitled to the same procedural protections upon a later application.

4. **No independent review of servicer decisions**. With the exception of the RHS direct loan program, none of the appeal procedures authorized by these protocols provides for review of a servicer's decision by a neutral decision-maker. Except for the RHS program, all require simply a review by the servicer's own supervisory staff. The reviews are completely "in-house", leading to serious conflicts of interest.

5. **Weak enforcement.** All of the protocols contain generalized statements to the effect that servicers are not to enforce obligations unless they have first considered alternatives. A provision

like this is critically important, but it should be clear and specific. In the mortgage area, servicers routinely ignore these directives and they are not well enforced.

3. **Create an Effective Complaint Process**

The Direct Loan contracts require servicers to respond and resolve customer complaints and create and execute a plan to escalate complaints to FSA and the ombudsman. In practice, however, it is not clear if borrowers know how to lodge complaints and if so, how these complaints are handled. The Department's web site provides tips to handle disputes. However, as of summer 2014, it does not describe a complaint process other than the Department of Education ombudsman.[6]

A robust complaint system is essential to allow borrowers the opportunity to get relief when servicers fail to perform and to track common issues and evaluate servicer performance.

E. Rigorous Enforcement

The Department of Education and the Consumer Financial Protection Bureau (CFPB) are the primary federal regulators of federal student loan servicers. The Department contracts with the Direct Loan servicers and therefore is the entity with the authority to enforce these contracts. The Department has authority to terminate contracts or otherwise penalize servicers that violate program requirements. Under existing authority, in addition to terminating contracts, the Department can:

- Choose not to assign further accounts to a servicer, or transfer existing accounts to other servicers, based on non-compliance with the contract,
- Unilaterally shift borrowers to other servicers,
- Decide not to reimburse servicers for loans that were not serviced in compliance with the contracts, and
- Terminate contracts if conflicts of interest arise or if necessary to avoid the appearance of a conflict of interest.

The Department has been lax in using these tools. Yet rigorous oversight is essential to preserve the integrity of the servicing system. Lax oversight may benefit servicers, but this is not an advantage given that the goals of the system should be to ensure that borrowers are protected and that taxpayer money is spent efficiently.

F. Provide Public Information

The Department has said that it has standards of good practice that it uses to evaluate servicers. The problem is that the public and borrowers do not know what those standards are

[6] https://studentaid.ed.gov/repay-loans/disputes

and if the Department enforces them. The lack of transparency is a major barrier to holding contractors accountable. It also opens the door to the current system in which rip-off third party debt relief companies are filling much of the gap in borrower service. This is unacceptable.

The Department should collect and make public information about servicing performance and any corrective actions. A July 2014 letter to the Department from U.S. Senators McCaskill and Warren lists key categories of information that the Department should provide on a regular basis including audits, cost estimates and performance reports.[7]

G. Study What Works

The government should study contractor performance and outcomes as a prerequisite to creating new systems. For example, there are no recent studies that we know of evaluating the effectiveness of rehabilitation and consolidation, the two main programs to help borrowers out of default.[8]

There is a similar lack of research on what works in servicing. To the extent research is being done, it appears to be mainly behind the scenes efforts by companies to gain competitive advantages. However, servicers do not publicly reveal this research either because they claim it is proprietary or because they claim that their contracts with the Department prohibit them from revealing this information. The proprietary model therefore creates a barrier to equal access to quality servicing.

H. Create a Process to Certify Non-Profit Counselors to Assist Borrowers

In addition to improving the substance of the student loan safety net, it is essential to create a network of certified non-profit student loan counselors. Counselors should be under the supervision of a lawyer or other professional who is knowledgeable about student loan law and keeps up with new developments. This is because even well-intentioned counselors may give erroneous advice about the often complex student loan programs. These agencies must be truly non-profit and should not receive high levels of funding from creditors or collectors. The Department should consider a certification system similar to the program HUD uses to certify trained and qualified housing counselors to provide assistance.

Thank you for your consideration of this response. Please feel free to contact Deanne Loonin if you have any questions or comments. (Ph: 617-542-8010; E-mail: dloonin@nclc.org).

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[7] A copy of the July letter from Senators McCaskill and Warren is available at: http://www.mccaskill.senate.gov/media-center/news-releases/mccaskill-warren-join-colleagues-to-question-department-of-education-on-oversight-and-renegotiation-of-student-loan-contracts-.

[8] The GAO has noted the Department's failure to track the effectiveness of rehabilitation. See U.S. Government Accountability Office, "Federal Student Loans: Better Oversight Could Improve Defaulted Loan Rehabilitation" (March 2014).